

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20070071330**

**To: Department of Enforcement
Financial Industry Regulatory Authority (FINRA)**

**Re: Legent Clearing LLC, Respondent
Member Firm
CRD No. 117176**

Pursuant to NASD Rule 9216 of FINRA's Code of Procedure, Legent Clearing LLC (Legent) submits this Letter of Acceptance, Waiver and Consent (AWC) for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Legent alleging violations based on the same factual findings described herein.

I. ACCEPTANCE AND CONSENT

- A. Legent hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

Background

Legent has been a member of FINRA or its predecessor, NASD, since June 4, 2002. Legent acts as a clearing broker offering its services to introducing broker/dealers on a fully disclosed basis from its main office located in Omaha, Nebraska. As a clearing firm, Legent performs order processing, settlement and record-keeping functions for introducing broker/dealers. These introducing broker/dealers do not maintain back-office facilities to perform these functions.

Relevant Prior Disciplinary History

Legent has been the subject of one formal disciplinary action by FINRA relevant to this matter. See AWC No. E0420040084 (fining Legent \$40,000 for, among other things, SEC Rule 15c3-3 violations).

Overview

Legent failed to develop and implement a written anti-money laundering (AML) program reasonably designed to achieve and monitor its compliance with the requirements of the Bank Secrecy Act during the period of February 1, 2004 through November 30, 2006 (the relevant AML period). Legent's AML program was not tailored to the Firm's business and did not adequately provide documentation of the Firm's AML activities. Among other things, Legent's written AML program did not adequately consider the money laundering risks posed by its introducing firms, some of which were conducting high risk AML activities, such as penny-stock liquidations. Further, while Legent experienced rapid growth during the relevant AML period, it

did not provide adequate resources to its AML program to account for this growth. As a consequence, Legent failed to file a Suspicious Activity Report (SAR) in a number of instances in which there did not appear to be any legitimate purpose for the transaction. Moreover, while in some instances Legent may have discussed some of these transactions internally, it did not conduct an adequate investigation to determine that the transactions were not in fact suspicious. In addition, Legent failed to document any discussions it might have had or the reason for any decision that it might have made not to file a SAR.

Legent also failed to provide an adequate AML training program for new and existing employees. For new employees, Legent's training program was limited to *ad hoc* instruction from departmental supervisors and a two-page document explaining money laundering. For existing employees, Legent's training program was limited to a short PowerPoint presentation at the firm's annual compliance meeting.

Through these deficiencies, Legent failed to develop and implement an adequate written AML program, in violation of NASD Conduct Rules 3011(a), 3011(b), 3011(e) and 2110, and MSRB Rule G-41.

In addition, from at least June 2004 through October 2006 (the relevant Reg. T period), Legent improperly extended credit by permitting cash account customers to use the proceeds of unsettled sale transactions to fund subsequent purchase and sale transactions. Legent also improperly extended credit by permitting customers to use the proceeds of unsettled sale transactions to meet the requirement that all securities purchased in cash accounts be paid for within five days of purchase date, regardless of whether and when the securities were subsequently sold. Legent also failed to have adequate supervisory systems and procedures to ensure compliance with Regulation T. As a result, Legent violated Regulation T, Parts 220.8(a) and (b), promulgated pursuant to Section 7 of the Securities Exchange Act of 1934 (the Exchange Act), and NASD Conduct Rules 2110 and 3010.

Finally, Legent failed to prepare an accurate reserve computation calculation in February 2007 and April 2006. This violated SEC Rule 15c3-3 and NASD Conduct Rule 2110.

Facts and Violative Conduct

Legent's AML Violations

Background

Legent became a member of FINRA in 2002. At the beginning of the relevant AML period, Legent provided clearing services to nine introducing firms. By the end of the relevant AML period, a little more than two and a half years later, that number had grown to 50, in locations across the United States, including New York City, Chicago and Los Angeles.

Some of these introducing firms engaged in activities that were high risk for AML purposes, such as penny-stock transactions, liquidations of proceeds, and frequent journaling activity among

various accounts which apparently were unrelated. Legent provided clearing services to some firms that, in addition to engaging in these high-risk activities, also had significant disciplinary backgrounds.

For example, Legent cleared for Franklin Ross, Inc. (Franklin Ross). Franklin Ross was the subject of two enforcement proceedings brought by FINRA during 2001-2002, including one that charged Section 5 of the 1933 Securities Act and supervisory violations. Also during the relevant AML period, FINRA brought an action against Franklin Ross in March 2006, alleging certain omissions by the firm in a private offering. Pursuant to that proceeding, Franklin Ross was suspended from participating in any securities offerings for one year and fined \$20,000, and the firm's president was suspended for 10 days from acting in any supervisory capacity. FINRA expelled Franklin Ross in 2007 for serious AML violations. *See* FINRA Press Release, November 5, 2007.

Legent also cleared for Salomon Grey Financial Corp. (Salomon Grey). The SEC charged Salomon Grey, and its President, Kyle Rowe, with fraud in connection with a market manipulation scheme, and sought a permanent injunction in a September 27, 2002 Complaint filed in the United States District Court for the District of Utah. In August 2004, FINRA found in a formal disciplinary proceeding that Salomon Grey and Rowe violated SEC Regulation M, along with NASD Conduct Rules 2710 and 2110. Salomon Grey and Rowe were fined \$100,000, and Rowe was suspended in all capacities for two weeks. Ultimately, FINRA expelled Salomon Grey and barred Rowe in April 2006 for AML and other serious supervisory violations. *See* FINRA Press Release, April 27, 2006.

Still another introducing firm that had a disciplinary history, and for which Legent provided clearing services, was Blackwell Donaldson & Company (Blackwell Donaldson). From 1999 to 2002, prior to the relevant AML period, Blackwell Donaldson was the subject of at least three separate regulatory enforcement actions, including one in which the firm was fined \$50,000 by the State of Oregon for, among other things, serious supervisory deficiencies relating to micro-cap stock transactions. In June 2006, FINRA brought an action against Blackwell Donaldson's Chief Executive Officer and Anti-Money Laundering Compliance Officer for his role in the firm's serious AML violations that occurred from March 2004 to August 2004, and suspended him for one year from acting in any supervisory capacity.¹

NASD Conduct Rule 3011 and MSRB Rule G-41

NASD Conduct Rule 3011, which became effective on April 24, 2002, requires FINRA members to develop and implement a written AML program reasonably designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act, 31 U.S.C. §5311, *et seq.*, and the regulations promulgated thereunder. Section (a) of this Rule directs member firms to establish and implement procedures reasonably designed to detect and cause the reporting of certain suspicious transactions. Section (b) requires firms to establish and implement procedures reasonably designed to achieve compliance with the Bank Secrecy Act. Section (e) requires firms

¹Blackwell Donaldson filed a Form BDW in March 2005.

to provide relevant on-going training to appropriate personnel. FINRA has issued numerous communications to its members regarding the requirements of Rule 3011. *See* Notice to Members (NTM) 02-21 (April 2002), 02-47 (August 2002), 02-50 (August 2002), 02-78 (November 2002), 02-80 (December 2002), 03-34 (June 2003) and 06-07 (February 2006).

MSRB Rule G-41 contains similar requirements for those broker/dealers engaged in municipal securities transactions.

NASD Conduct Rule 3011(a) requires FINRA members to establish and implement policies and procedures "that can be reasonably expected to detect and cause the reporting of" suspicious transactions. On July 2, 2002, the Department of Treasury issued the regulation requiring suspicious transaction reporting for broker/dealers, 31 CFR §103.19(a)(1). It required all broker/dealers to file with Treasury's Financial Crimes Enforcement Network (FinCEN) "a report of any suspicious transaction relevant to a possible violation of law or regulation." Treasury's release stated that broker/dealers should determine whether activities and transactions raise suspicions by looking for "red flags." NTM 02-47 discussed Treasury's release, set forth the provisions of the final AML rule, and provided various examples of "red flags." This NTM further advised broker/dealers of their duty to file a SAR to report certain suspicious transactions.² Further, NTM 02-21 emphasized each firm's duty to detect "red flags" and, if it detected any, "perform additional due diligence before proceeding with the transaction." NTM 02-21, p. 10.

Legent's Failure to File SARS
Or Investigate Suspicious Activities

During the relevant AML period, Legent failed to file SARS in numerous instances as described below. Legent cleared certain penny-stock transactions that presented patterns that necessitated, at a minimum, further investigation by Legent. More importantly, in many instances these patterns should have led to a SAR filing. In these instances Legent did not undertake adequate further investigation, did not consider filing a SAR, and did not file a SAR. *See* NTM 02-47, pp. 2-3 (outlining circumstances pursuant to which broker/dealer must file a SAR); *see also In the Matter of Park Financial Group, Inc. and Gordon C. Cantley*, SEC Rel. No. 56902, Admin. Proc. File No. 3-12614, p.4 (SEC Dec. 5, 2007) ("The failure to file a SAR as required by 31 C.F.R. § 103.19 is a violation of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder."). Also significant, to the extent Legent undertook any investigation, or considered filing a SAR but ultimately decided not to do so, Legent failed to document such investigation or decision.

²"Pursuant to the final rule, a broker/dealer must report a transaction on Form SAR-SF if 'the transaction involves \$5,000 or more, is conducted or attempted to be conducted through the broker/dealer and appears to serve no business or apparent lawful purpose....'" NTM 02-47, p. 2. The obligation to file a SAR may arise from a single transaction or from a series of transactions that form a suspicious pattern of activity. *Id.* NTM 02-47 quoted FinCEN's release on the final rule relating to SARS, stating, "In its release adopting the final rule, FinCEN explicitly clarifies that 'if a broker/dealer determines that a series of transactions that would not independently trigger the suspicion of the broker/dealer, but that taken together, form a suspicious pattern of activity, the broker/dealer must file a suspicious transaction report.'"

Examples of these failures by Legent are described below.

Solucorp Industries Ltd.

During the relevant AML period, Legent failed to file a SAR relating to suspicious transactions involving the stock of Solucorp Industries Ltd. (Solucorp). Beginning in January 2005, Solucorp stock was journaled among numerous accounts cleared by Legent that had no apparent relationship with one another. At least one of the accounts was held by a former insider of Solucorp who had a securities disciplinary history. Legent's records did not show any evidence of any inquiry regarding the relationship between the accounts, or any investigation into the journaling activities or business purpose for the transactions.

Specifically, on January 6, 2005, a stock promoter, B.M.I., journaled 25,000 shares, worth \$35,500, to an individual, R.G., through an account at a firm that cleared through Legent. On January 19, 2005, B.M.I. received 100,000 physical shares into its account. On February 16, 2005, B.M.I. journaled 25,000 shares, worth \$42,750, to G.E.U.I. On February 17, 2005, Solucorp issued a press release regarding a purported business relationship with a new manufacturer for a subsidiary's products.

Later, in October 2005, a former insider of Solucorp engaged in several suspicious transactions. Specifically, on October 12, 2005, one day after Solucorp issued a press release regarding an agreement with a new manufacturer, the former insider, J.K., received 41,000 shares of Solucorp stock, valued at \$71,750, by journal from R.M. On January 6, 2006, J.K. journaled 40,000 shares, valued at \$54,800, to H.Mc.

Legent should have given heightened scrutiny to J.K.'s suspicious transactions. The SEC announced in a Litigation Release on August 25, 2003 that Solucorp had been enjoined from violating Section 10(b) and Rule 10b-5 pursuant to a March 12, 2003 Order entered by the United States District Court for the Southern District of New York. J.K. was expressly identified in that press release as an executive who "knowingly and deliberately falsified [press releases and financial statements] with the intention of deceiving shareholders and potential investors or, at the very least, [was] guilty of reckless disregard for the truth or falsity of the disclosures."

Legent also should have identified that all of the suspicious transactions were conducted through the same introducing broker/dealer. In fact, B.M.I. the stock promoter who received and journaled out shares, had the same business address as the business address for the introducing broker/dealer where the accounts were held.

Moreover, M.B., the President and Chief Compliance Officer of the introducing broker/dealer, also conducted certain suspicious transactions in Solucorp stock. On January 4, 2006, M.B. received 150,000 physical shares of Solucorp into his account. Further, on April 13, 2006, August 2, 2006, and September 28, 2006, M.B. received 100,000 physical shares of Solucorp into his account on each of these days.

These transactions were "red flags." There did not appear to be any legitimate business purpose for any of these transactions. Legent did not detect that the stock promoter had the same physical

address as the introducing broker/dealer. Legent also did not identify that J.K. was a former insider of Solucorp. Legent did not file a SAR relating to these transactions.

Broadband Wireless International Corp.

During the relevant AML period, Legent failed to file a SAR relating to suspicious transactions involving Broadband Wireless International Corporation (Broadband). Beginning in February 2004, Broadband stock was journaled among numerous accounts cleared by Legent that had no apparent relationship with one another. At least one of the accounts was held by an insider of Broadband. All of the suspicious transactions were conducted through the same introducing broker/dealer. Legent's records did not show any evidence of any inquiry regarding the relationship between the accounts, or any investigation into the journaling activities or business purpose for the transactions.

The suspicious transactions occurred between the accounts of individuals K.Mc. and M.D, and an entity known as B.C.M.C.I. K.Mc. was an officer and director of Broadband, and M.D. was identified as a consultant to Broadband.

On February 6, 2004, K.Mc. journaled 500,000 shares of Broadband, valued at \$18,000, to B.C.M.C.I. through an account at a firm that cleared through Legent. On February 10, 2004, K.Mc. journaled 600,000 shares valued at \$29,400 to B.C.M.C.I. Between February 6 and February 27, K.Mc. sold 500,000 Broadband shares for \$25,427.74.

On March 5, 2004, M.D. journaled 3.2 million shares of Broadband, valued at \$220,800, to B.C.M.C.I. On March 8, B.C.M.C.I. journaled 3 million shares, valued at \$216,000, to an entity known as E.A.J.

Significant journaling activity of Broadband shares continued through the spring and into the summer of 2004. M.D. journaled 3 million shares to B.C.M.C.I. on March 18. B.C.M.C.I. journaled 2.5 million shares to E.A.J. on March 19. On April 14, M.D. journaled over 3 million shares to B.C.M.C.I. On May 5, K.Mc. received 1.6 million shares into his account. On June 10, K.Mc. received over 5 million physical shares into one account for which Legent provided clearing services, and also received 9 million shares in a different account cleared through Legent.

These transactions were "red flags." The Letters of Authorization requesting the transfers of shares of Broadband stock did not provide any reason for the journal activities, and did not explain any relationship between the parties. There did not appear to be any legitimate business purpose for any of these transactions. Legent did not detect that K.Mc. and M.D. had business relationships with Broadband, or that K.Mc. was an insider of Broadband. Legent did not file a SAR relating to these transactions.

American Energy Production

During the relevant AML period, Legent failed to file a SAR relating to suspicious transactions involving American Energy Production (American Energy). Beginning in March 2004,

American Energy stock was journaled among numerous accounts cleared by Legent that had no apparent relationship with one another. Several of these accounts were held by stock promoters. Legent's records did not show any evidence of any inquiry regarding the relationship between the accounts, or any investigation into the journaling activities or business purpose for the transactions.

Specifically, in March 2004 A.C.I., a penny-stock promoter, received 1.9 million shares of American Energy into its account, which were valued at approximately \$117,500. This account was at a firm that cleared through Legent. In less than two weeks, A.C.I. journaled out of its account 1,442,500 shares of American Energy to three different parties which were apparently unrelated: A.I., W.S.C.F. and Ri.M. A.I., a penny-stock promoter, journaled out 260,000 shares of American Energy to W.S.C.F. from March 17-19, 2004.

Also, in March 2004 W.S.C.F., yet another stock promoter, sent four wire transfers from its account cleared by Legent to various unidentified bank accounts, while A.I. sent two wire transfers to various unidentified bank accounts. These suspicious transactions occurred at the same time that American Energy was issuing press releases that provided significant favorable news for the company.

These transactions were "red flags." There did not appear to be any legitimate business purpose for any of these transactions. All of these accounts were held at Blackwell Donaldson, which had a relevant disciplinary history and a high incidence of high-risk transactions. Legent did not file a SAR relating to these transactions.

American Multiplexer Corp.

During the relevant AML period, Legent failed to file a SAR relating to suspicious transactions involving American Multiplexer Corp. (American Multiplexer). Beginning in March 2004, American Multiplexer was journaled among several accounts cleared by Legent that had no apparent relationship with one another, including accounts held by stock promoters A.C.I. and A.I. Legent's records did not show any evidence of any inquiry regarding the relationship between the accounts, or any investigation into the journaling activities or business purpose for the transactions.

Specifically, on March 4, 2004, A.C.I. received 250,000 shares into its account. On March 9, American Multiplexer issued a press release regarding the alleged formation of a retail distribution partnership with Amazon.com. On March 10, A.C.I. sold 30,000 shares for \$12,963.46, and on March 17 A.C.I. sold an additional 42,500 shares of American Multiplexer, worth \$17,934.28. On March 11, A.C.I. journaled 97,500 shares to A.I. A.I. sold the same number of shares on March 17 as A.C.I. had sold (42,500) and received the same price (\$17,934.28).

On May 19, 2004, A.I. journaled 50,000 shares to A.C.I. and also journaled 200,000 shares, valued at \$72,000, to another stock promoter, M.V.C. On June 1, A.I. and A.C.I. each journaled 50,000 shares apiece to M.V.C. This 100,000 share transfer to M.V.C. was worth \$27,000.

On June 1, American Multiplexer issued another press release regarding its appointment of an additional authorized distributor of its product line, and on June 23 issued another press release. On June 23, A.I. journaled an additional 350,000 shares to A.C.I. In June and July 2004, A.C.I. and A.I. each sold 215,000 shares.

These transactions were “red flags.” There did not appear to be any legitimate business purpose for any of these transactions. All of these accounts were held at Blackwell Donaldson, which had a relevant disciplinary history and a high incidence of high-risk transactions. Legent did not file a SAR relating to these transactions.

Paragon Financial Corp.

During the relevant AML period, Legent failed to file a SAR relating to suspicious transactions involving Paragon Financial Corp. (Paragon). Beginning in September 2004, Paragon stock was journaled among numerous accounts cleared by Legent that had no apparent relationship with one another. At least one of the accounts was held by an insider of Paragon. Legent’s records did not show any evidence of any inquiry regarding the relationship between the accounts, or any investigation into the journaling activities or business purpose for the transactions.

Specifically, the suspicious Paragon transactions involved C.L., a former officer of Paragon and a greater-than-5% shareholder in the company. Paragon reported, on a Schedule 14A filed with the SEC in April 2004, that C.L. had ceased being an executive of the company. However, the April 2004 Schedule 14A disclosed that C.L. had an 11.1% ownership interest in Paragon, and a June 2005 Schedule 14A disclosed that C.L. had a 9.3% ownership interest in Paragon. On September 22, 2004, C.L. journaled 630,000 shares of Paragon, valued at approximately \$88,200, to three different individuals. On January 5, 2005, C.L. journaled another 125,000 shares to one of the three individuals, worth about an additional \$5,000.

These transactions were “red flags.” There did not appear to be any legitimate business purpose for any of these transactions. Legent did not detect that C.L. was an insider of Paragon. Legent did not file a SAR relating to these transactions.

Infinicall Corp.

During the relevant AML period, Legent failed to file a SAR relating to suspicious transactions involving Infinicall Corp. (Infinicall). Beginning in August 2005, Infinicall stock was journaled to accounts cleared by Legent that had no apparent relationship with one another. At the center of the journaling activity was an account held in the name of an insider of Infinicall, J.T. While Legent initially questioned the introducing broker/dealer about J.T. and his transactions in Infinicall stock, Legent did not conduct a reasonable follow-up inquiry on the matter to verify that the transactions had a legitimate business purpose.

Specifically, the suspicious Infinicall transactions involved J.T. and T.E.G.L. J.T. was listed, in various Infinicall SEC filings made from June 2005 to February 2006, as Interim Chief Financial Officer, Director and Secretary of Infinicall. J.T. was also listed as the Assistant Secretary and Attorney for T.E.G.L.

On July 29, 2005, T.E.G.L. received 10,216,607 shares of Infinicall stock in its account, which Legent cleared. T.E.G.L. journaled 8,825,000 shares of this stock, valued at approximately \$259,825, to five apparently unrelated accounts from August 2005 through March 2006.

Legent initially asked the introducing broker/dealer about the business purpose of the transactions, and noted that J.T. had an affiliation with Infinicall. The introducing broker/dealer responded that there was a “business relationship between these customers” and the introducing firm’s belief that the customers were “compensated in stock instead of cash.”

Legent was unable to demonstrate that it conducted any follow-up to determine what the relationship was among the parties to these transactions, or the business purpose of the transactions. Legent could not demonstrate that it requested documentation directly from the customers or the introducing broker/dealer.

J.T. later requested, pursuant to a December 12, 2005, Letter of Authorization, the transfer of an additional 600,000 shares of Infinicall to N.L. Again, no inquiry was conducted to ascertain the business purpose of the journals.

These transactions were “red flags.” There did not appear to be any legitimate business purpose for any of these transactions. While Legent initially detected that J.T. may have been an insider of Infinicall, it did not conduct a reasonable follow-up investigation to ascertain the business purpose of the activities or the relationship between the parties. Legent did not file a SAR relating to these transactions.

Legent’s foregoing conduct violated NASD Conduct Rules 3011(a) and 2110 and MSRB Rule G-41.

Legent’s Failure To Timely File SARS

While Legent filed some SARS during the relevant AML period, in several instances it did so many months after the inception of suspicious conduct. For instance, in one SAR filing Legent identified that the suspicious activity had commenced nearly 16 months before the SAR was filed.

Such delay in filing SARS is inconsistent with guidance provided by FinCEN and FINRA. As discussed in NTM 02-47, p. 4, “Broker/dealers must file Form SAR-SF within 30 days of becoming aware of the suspicious transaction. If the broker/dealer is unable to identify a suspect, the rule provides an extra 30 days for filing the Form SAR-SF.” *See also The SAR Activity Review, Trends, Tips & Issues*, Issue 10, p. 45 (May 2006) (“The time period to file a SAR starts when the institution, in the course of its review or as a result of other factors, reaches the conclusion in which it knows, or has reason to suspect, that the activity or transactions under review meets one or more of the definitions of suspicious activity. The 30-day . . . period does not begin until an appropriate review is conducted and a determination is made that the transaction under review is ‘suspicious’ within the meaning of the SAR regulations.”).

Legent's foregoing conduct violated NASD Conduct Rules 3011(a) and 2110 and MSRB Rule G-41.

Legent's AML Program and Written Procedures Were Inadequate

Legent's AML program and written procedures were inadequate for a number of reasons. For instance, the procedures were not specifically tailored to Legent's particular business model. FINRA NTM 02-21 emphasized that firms should not use a "one-size-fits-all" approach in crafting an AML program and procedures. Moreover, the resources that Legent committed to its AML program did not keep pace with the firm's rapid growth during the relevant AML period.

Some of the introducing firms for which Legent provided clearing services engaged in a significant number of transactions that were high risk for AML purposes, such as penny-stock transactions, liquidation of proceeds, and frequent journaling activity among various accounts which were apparently unrelated. Some of these same firms had securities industry disciplinary histories.

As a clearing firm, Legent was obligated to consider the money laundering risks posed by the introducing firms with which Legent did business, including information Legent obtained in the course of its relationship with the introducing firm. *See* FinCEN Guidance, FIN-2006-G009, p.2 (May 10, 2006) ("In a relationship with an introducing firm, a clearing firm must consider the money laundering risks posed by the introducing firm, including any information the clearing firm acquires about the account base of the introducing firm in the ordinary course of its business and through the application of its anti-money laundering policies, procedures, and controls."). Legent did not adequately consider these risks in its AML program, or in actual practice.

FINRA has provided examples of "red flags" for money laundering including, but not limited to, the following:

- The customer engages in excessive journal entries between related accounts without any apparent business purpose, or,
- The customer, for no apparent reason or in conjunction with other 'red flags,' engages in transactions involving certain types of securities, such as penny stocks....

NTM 02-21, pp. 10-11.

Legent's AML program and written procedures did not adequately identify these "red flags" and risks. Instead, for much of the relevant AML period, Legent simply imported text from FINRA's AML program Small Firm Template and did not tailor the Template to its business. By doing so, Legent did not account for the unique AML risks it faced.

Legent updated its AML written procedures near the end of the relevant AML period, in August 2006, and for the first time expressly recognized in them one of the major AML risks it faced as a clearing firm – the journaling and transferring of assets by its introducing firms' customers.

While the August 2006 procedures acknowledged this risk, they did not adequately address the surveillance of introducing firms' customer accounts for suspicious journaling activity.

Further, Legent's AML program and written procedures were inadequate because they lacked many necessary details. FINRA has provided guidance to the industry, directing that AML written procedures "must establish and implement controls and written procedures that explain the procedures that must be followed, the person responsible for carrying out such procedures, how frequently such procedures must be performed, and how compliance with the procedures should be documented and tested." FINRA NTM 02-21, p. 5.

For instance, each of the firm's written procedures in effect during the relevant AML period generally required the use and review of exception reports to monitor account activity. However, until August 2006, none of the written procedures actually identified or described any of the exception reports to be reviewed, nor did they describe the process to be used in reviewing these reports. Several versions required documentation of the review without describing how or where the review was to be documented, while other versions did not require documentation at all. The procedures did not assign responsibility to specific people, but instead required the review to be done by unspecified "Operations personal [sic], Traders, and the Anti-Money Laundering Compliance Officer." Legent's December 2005 independent audit discovered this deficiency and recommended adding specific details and descriptions, but Legent did not follow the recommendation until near the end of the relevant AML period.

Legent's AML procedures also did not specify how Legent's department heads were to use "desk procedures" created by the departments. The "desk procedures" were essentially step-by-step guidelines on how the departments were to conduct their functions to comply with broker/dealer regulatory requirements. However, the "desk procedures" were not tailored to address AML issues, and were not reviewed or drafted by Legent's Anti-Money Laundering Compliance Officer (AMLCO).

Legent's foregoing conduct violated NASD Conduct Rules 3011(a)-(b) and 2110 and MSRB Rule G-41.

The Firm's AML Training Program was Deficient

Legent's AML training program during the relevant AML period was deficient. At the beginning of the relevant AML period, Legent did not provide any uniform AML training for its new employees. Instead, Legent relied on its departmental supervisors to give new employees whatever AML training a particular supervisor deemed necessary. There were no controls or procedures in place to ensure that AML training was provided. Legent's AMLCO did not take part in the training that the departmental supervisors were providing to their new employees.

In approximately December 2005, Legent began giving new employees a two-page document that provided a brief explanation of the Patriot Act, money laundering and AML. New employees would receive this two-page document, along with other new employee forms and documents, on their first day of work at Legent. There still was no training provided by or supervised by the AMLCO or compliance department, or a senior officer of Legent. FINRA has advised member

firms that “[t]he AML employee training should be developed under the leadership of the AML Compliance Officer or senior management.” NTM 02-21, p. 14. The foregoing process for training new employees existed through the end of the relevant AML period, and into January 2007.

As for existing employees, Legent’s training occurred at its annual compliance meeting, and consisted of a short PowerPoint presentation made by the AMLCO. Legent provided no additional, focused, AML training to employees who had specific AML responsibilities. This level of training was not sufficient, given the types of business for which Legent was providing clearing services.

Legent’s foregoing conduct violated NASD Conduct Rules 3011(c) and 2110 and MSRB Rule G-41.

Legent’s Regulation T Violations

The Application of Regulation T to Cash Accounts

Legent violated Regulation T by failing to ensure (i) that securities were fully paid for prior to sale and (ii) that securities were fully paid for within two days of settlement.

In Cash Accounts, Payment for Securities is Required Prior to Sale

Section 7(c) of the Exchange Act provides that:

It shall be unlawful for any member of a national securities exchange or any broker or dealer, directly or indirectly, to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer – on any security (other than an exempted security) ... in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System ... shall prescribe.

Part 220.8(a) of Regulation T provides in relevant part:

- (a) *Permissible Transactions.* In a cash account, a creditor, may:
 - (1) Buy for or sell to any customer any security or other asset if:
 - (i) There are sufficient funds in the account; or
 - (ii) The creditor accepts in good faith the customer’s agreement that the customer will promptly make full cash payment for the security or asset before selling it and does not contemplate selling it prior to making such payment.
 - (2) Buy from or sell for any customer any security or other asset if:

- (i) The security is held in the account; or
- (ii) The creditor accepts in good faith the customer's statement that the security is owned by the customer or the customer's principal, and that it will be promptly deposited in the account

In transactions between a principal disclosed clearing firm and an introducing broker, the clearing firm is responsible for Regulation T compliance, because it is considered the creditor that extends the credit. *See* Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services, Part 5-615.971 (Apr. 19, 1991). Under Regulation T, securities may be purchased in a cash account only if the customer has sufficient funds in the account to pay for the purchase, independent of the proceeds to be received from the subsequent sale of those securities. *See, e.g.,* Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services, Part 5-616.11 (May 27, 1994). Additionally, the sale of a security to pay for another security purchased on the same date does not give rise to sufficient funds in the account by the applicable deadline. *See, e.g.,* Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services, Part 5-616.14 (Feb. 18, 1999). *See also* Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services, Part 5-616.15 (Jan. 6, 2000); Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services, Part 5-615.971) (Apr. 19, 1991).

A Federal Reserve Board staff opinion addressed a situation in which a customer sells Stock A on Day 1, buys Stock B on Day 2, sells Stock B on Day 3, and then buys and sells Stock C on day 5. Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services, Part 5-616.18 (May 12, 2003). The fact pattern assumed that all of the individual purchases cost less than the "account balance" and that Stock A had been paid for before it was sold on Day 1. The Board staff stated that Regulation T allows two methods for paying for a securities purchase in a cash account: (1) a customer who has sufficient funds in the account on trade date may purchase securities and sell them at any time; and (2) a customer who does not have sufficient funds in the account on trade date may purchase securities with the understanding that such securities will not be sold until they are paid in full. The opinion emphasized that sale proceeds that had not yet been received do not constitute "sufficient funds."

Under the facts presented in the foregoing example, the staff opinion stated that the sale of Stock B on Day 3 was inconsistent with the agreement that the customer will promptly make full cash payment for the security or asset before selling it and does not contemplate selling it prior to making such payment. The opinion also concluded that the sale of Stock B on Day 3, before the cash to pay for it was received, should put the broker/dealer on notice that the customer has engaged in a transaction that is not permissible in the cash account. The opinion further stated that the purchase of Stock C on Day 5 would therefore also have to be made pursuant to section 220.8(a)(1)(ii), with the result that the sale of Stock C on Day 5 was also a transaction that is not permissible in the cash account. The opinion noted that this interpretation did not set forth a new legal proposition, explaining that for over 50 years, Regulation T has required customers to pay for securities purchased in a cash account before selling them.

NASD issued Notice to Members 04-38, *Credit Extension/Day Trading Requirements* (May 2004) stating as follows:

[Federal Reserve Board] interpretations make clear that a customer who sells a security on trade date to pay for another security purchased on that day does not have “sufficient funds in the account” on trade date for purposes of Reg T Section 220.8(a)(1)(i). Rather a customer must make full payment for each separate purchase transaction in a cash account without regard to the unsettled proceeds of securities sold. If a member firm plans to accept the unsettled proceeds of a securities sale as payment for securities purchased, the transaction must be conducted in a margin account, subject to the regulations affording protection to customers who trade in margin accounts. [Citations omitted]

In Cash Accounts, Payment for Securities is Required within Two Days of Settlement

Part 220.8(b) of Regulation T provides the time periods when payment for securities purchase must be made and states in relevant part:

- (b) *Time periods for payment; cancellation or liquidation –*
 - (1) *Full cash payment.* A creditor shall obtain full cash payment for customer purchases:
 - (i) Within one payment period of the date:
 - (A) Any nonexempted security was purchased.

In turn, Part 220.2 defines “payment period” to mean “the number of business days in the standard securities settlement cycle in the United States ... plus two business days.”

In a Federal Reserve Board Staff Opinion dated September 30, 1986, the staff addressed the question of whether a customer can “use sale proceeds of one security to pay for the purchase of a different security, so long as the trade date of the sale is on or before the settlement date of the purchase transaction.” Fed. Res. Staff Op., Part 5-615.94 (Sept. 30, 1986). The staff answered the question by writing, “No, since the sale transaction will not settle until after settlement of the purchase transaction, there are insufficient funds in the account on settlement date. In addition, an extension of time could not be granted by a self regulatory organization in this case because there is no acceptable reason for an extension under Section 220.8(d).” *Id.*

The Violations

During the relevant Reg. T period, Legent effected improper trades by permitting customers to sell securities in cash accounts before making full cash payment in violation of Regulation T on numerous occasions. In one month alone, there were 77 violations, and the practice continued for 29 months. Additionally, Legent failed to properly restrict accounts from trading subsequent to this activity.

During the relevant Reg. T period, Legent also failed to ensure that, for each transaction in a cash account, full cash payment was made within two days of the settlement of such purchase, regardless of whether or when the security was sold. Specifically, the firm failed to fully and properly monitor whether proceeds from the sale of one security would settle before the payment deadline set forth in Part 220.8(b) of Regulation T for the purchase of a different security. The firm's procedures permitted it to improperly consider the purchase of one security in an account with insufficient cash to be timely paid for as long as the settlement of proceeds from the sale of another security of equal or greater value was pending at the time of the payment deadline. Part 220.8(b) of Regulation T prohibits such consideration of unsettled proceeds as cash payment.

Legent failed to adequately supervise transactions in securities in cash accounts to determine (i) whether securities were fully paid for prior to sale and (ii) whether securities were fully paid for within two days of settlement. Additionally, Legent's written supervisory procedures did not adequately address the provisions of Regulation T as described above. As a result, customers were permitted to sell securities before they were fully paid.

The foregoing acts, practices and conduct by Legent constitute separate and distinct violations of Regulation T and NASD Conduct Rules 2110 and 3010.

Legent's SEC Rule 15c3-3 Violations

Legent failed to make an accurate reserve computation as of February 28, 2007. Legent failed to include an amount in Item 3 of the reserve formula, thereby understating total credits by \$4,783,010.91. Based on that computation, Legent withdrew \$2,000,000 from its special reserve account on March 2, 2007. Legent subsequently recomputed the reserve computation as of February 28, 2007, and determined that the excess of total credits over total debits was \$6,056,683.75. This created a special reserve account deficiency of \$4,406,374.32 and, after some additional modifications were made to the computation, the total special reserve account deficiency was \$4,434,754.32.

Legent also failed to make an accurate reserve computation as of April 28, 2006. This related to the firm having unduly concentrated margin balances in three customer accounts. Legent excluded these items from the computation on the basis that they related to a commingled customer loan, which was a credit item in the reserve formula. Legent erroneously offset the required reductions in debits by attempting to demonstrate that the securities pledged were included as collateral for a commingled loan. However, under the circumstances, individual loans needed to be established for each account to demonstrate that the debits were directly related to a credit item in the reserve formula. Further, the firm failed to obtain approval from its designated examining authority to permit the concentrated debit balances to be included in its reserve computation formula. This reduced customer debits by \$13,880,931, and led to a reserve computation deficiency of \$5,842,596 as of April 28, 2006.

Legent's conduct violated SEC Rule 15c3-3 and, consequently, NASD Conduct Rule 2110.

B. Legent also consents to the imposition of the following sanctions:

A censure and monetary fine of \$350,000.

Legent specifically and voluntarily waives any right to claim that Legent is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter. Legent has submitted an Election of Payment form showing the method by which Legent proposes to pay the fine imposed.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II. WAIVER OF PROCEDURAL RIGHTS

Legent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against Legent;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council (NAC) and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Legent specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Legent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of NASD Rule 9143 or the separation of functions prohibitions of NASD Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III. OTHER MATTERS

Legent understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (ODA), pursuant to NASD Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of

the allegations against Legent; and

C. If accepted:

1. this AWC will become part of Legent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Legent;
2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about Legent's disciplinary record;
3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-3; and
4. Legent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Legent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Legent's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

D. Legent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Legent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

Letter of Acceptance, Waiver and Consent No. 20070071330
Legent Clearing LLC
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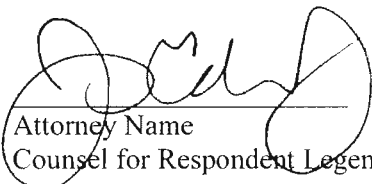
Legent certifies that Legent has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that Legent has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce Legent to submit it.

LEGENT CLEARING LLC

Date: 12/3/08

By: Craig Black
Title: CEO

Reviewed by:


Attorney Name
Counsel for Respondent Legent

Firm Name Joseph D. Edmondson, Jr. / Foley & Lardner LLP
Address 3000 K Street, N.W., Suite 500
City/State/Zip Washington, DC 20007
Phone Number 202-672-5354

Letter of Acceptance, Wavier and Consent No. 20070071330
Legent Clearing LLC
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Accepted by FINRA:

Date

Signed on behalf of the Director of ODA,
by delegated authority

Katherine A. Malfa
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